



The new legal framework for deposit guarantee schemes

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Coverage and funding - Two main roads
towards a common DGS?

Financial Law Clinic – 16 May 2014
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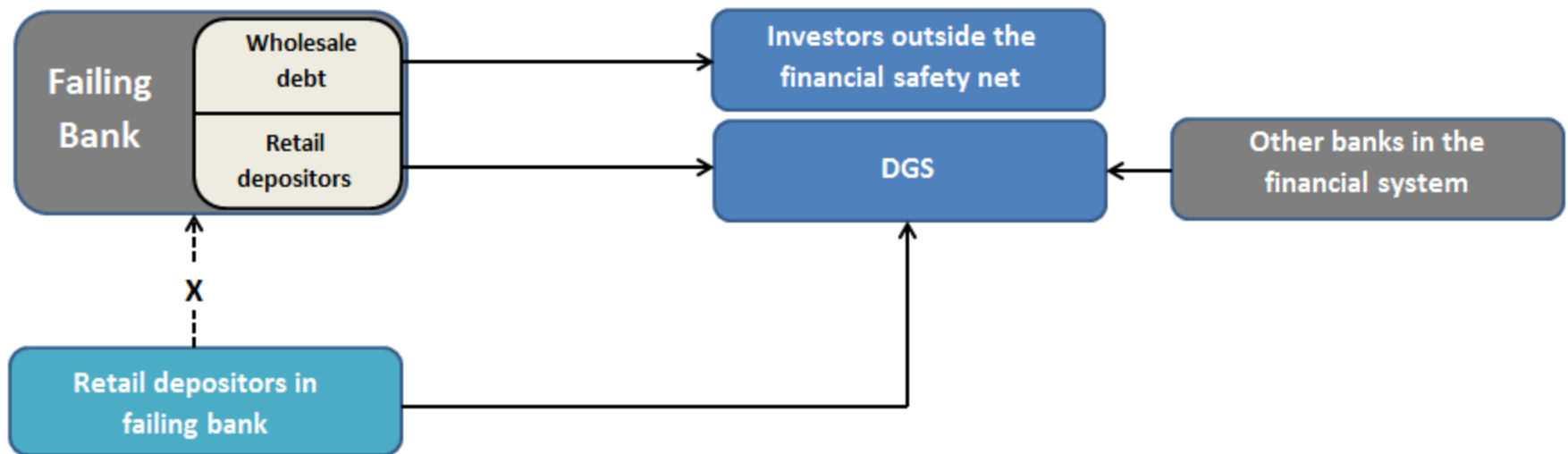
Overview

- I. Background
- II. Coverage and funding – Two main roads?
 - II.1 Coverage (ARCO)
 - II.2 Funding (Argenta Spaarbank)
- III. Conclusion

I. Background

Structure of a DGS

- Theory: mutual insurance policy
 - Immediate payment → may be financed by government
 - Ultimate cost → falls on remaining banks in the system



I. Background

Goal(s) of a DGS

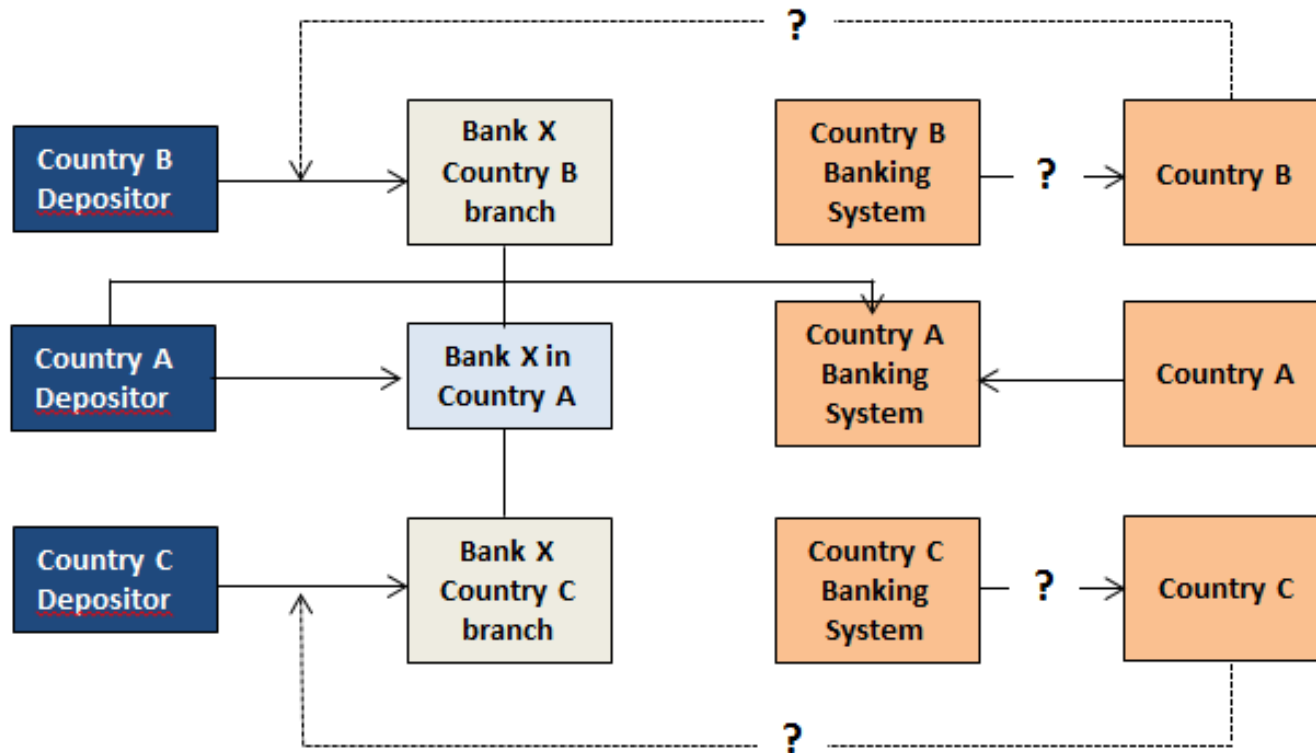
Depositor-protection	Financial stability
<ul style="list-style-type: none">○ Pro:<ul style="list-style-type: none">• Safeguarding financial wealth of households in times of crisis• Reduction of customer's information cost○ Con:<ul style="list-style-type: none">• Moral hazard (choosing bank)	<ul style="list-style-type: none">○ Pro:<ul style="list-style-type: none">• Level playing field for all banks• DGS allows institutions to fail○ Con:<ul style="list-style-type: none">• Moral hazard (choosing investments)

Optimal system?

- Trade-off between protection and financial stability
- Broader context of the financial safety net

I. Background

- Global financial system = global problems (home/host issue)



I. Background

EU safety net - Banking Union

- Three pillars:
 - Supervision (SSM)
 - Resolution (SRM)
 - Deposit Guarantee (DGS)
 - Recommendation 87/63/EEC
 - Directive 94/19/EC
 - Directive 2009/14/EC
 - 12 July 2010 Proposal for a directive
 - 17 December 2013 – Political agreement EP
 - 18 February 2014 – Approval by Council
 - 15 April 2014 – Adoption by EP

I. Background

Banking Union – Links between pillars

- Proposal for a “Bank Recovery and Resolution Directive”
 - 12 December 2013: trilogue agreement on the framework for bank recovery and resolution
 - 15 April 2014 – Adoption by the EP
 - Links with Deposit Guarantee Directive:
 - Art. 98a: higher priority ranking of claims re deposits from natural persons and SMEs in insolvency proceedings;
 - Art. 99: use of DGS funds when resolution action is undertaken

I. Background

- EU Solution: *common* EU Deposit Guarantee System ?

→ Maximum harmonisation?

94/19/EC	2009/14/EC	Proposal	Political agreement
NO	NO (Recital 8), <i>but</i> max-harmonisation of the minimum coverage level and pay-out delays (Recital 17)	YES Recital 5: <i>Directive 94/19/EC was based on the principle of minimum harmonisation. (...)</i> Recital 6: (...). <i>Therefore, deposit protection should be harmonised and simplified to the largest extent possible.</i>	YES Recital 5: (...) <i>a variety of DGS with very distinct features currently exist in the Union. As a result of the formulation of common requirements laid down in this Directive, a uniform level of protection is provided for depositors throughout the Union while ensuring the same level of stability of DGS. At the same time, those common requirements are of the utmost importance in order to eliminate market distortions. This Directive therefore contributes to completion of the internal market.</i>

I. Background

Which roads lead to a common DGS?

- Gradual approach → further harmonisation of national systems beyond the current proposal / political agreement
- Important dimensions:
 - coverage (type of deposit/depositor covered and up to which amount);
 - funding standards (and in particular the relationship between *ex ante* and *ex post* funding);
 - a target *ex ante* fund size;
 - payout periods;
 - borrowing between DGSs;
 - etc.

II. Coverage and funding – Two main roads?

II.1 Belgian DGS - Legal framework

II.2 Coverage

- Scope (members / beneficiaries / covered assets)
- “ARCO”-case

II.3 Funding

- Principles
- “Argenta Spaarbank”-case

II.1 Belgian DGS

II.1 Belgian DGS – (Old) Legal framework

Art. 110-110sexies (old) Banking Law (Law of 22 March 1993)

Protection Fund (separate legal entity)	Special Protection Fund (part of the deposit and consignment office)
<p>Created in February 1999</p> <ul style="list-style-type: none">• Law of 17 December 1998 <p>(Deposits and) financial instruments</p> <p>Organisation</p> <ul style="list-style-type: none">• Non-public protocol• Compensation Regulation of 1 January 2011	<p>Wake of the financial crisis (2008)</p> <ul style="list-style-type: none">• Law of 15 October 2008 (RD of 14 November 2008) <p>Deposits and life insurances</p> <p>Organisation</p> <ul style="list-style-type: none">• RD of 14 November 2008• RD of 16 March 2009

II.1 Belgian DGS – New legal framework

- “New” Banking Law

(Art. 380-384 Law of 25 April 2014, *Belgian Official Gazette*, May 7, 2014, ed. 2, 36794)

- First step towards realization of the EU Banking Union

(Report Chamber of Representatives, March 31, 2014, *Parl. St.* DOC 53 3406/005)

- Something new under the sun?

- “**Guarantee Fund**” = “Special Protection Fund” (art. 4, 22° Banking Law)
- Covered deposits and claims from the Guarantee Fund: general preferential right on all movable property of defaulting bank (art. 389 Banking Law)
- “Asset encumbrance ratio” (art. 110, §2 Banking Law)

II.2 Coverage

II.2 Coverage – Scope

Scope of application (members)		
Directive 94/19/EC	Special Protection Fund (BE)	Proposal = Political agreement
Credit institutions <ul style="list-style-type: none"> • Compulsory • Exemptions possible Branches <ul style="list-style-type: none"> • Principle • But: art. 389 Banking Law 	Credit institutions <ul style="list-style-type: none"> • Compulsory • Possibility to create exemptions abolished by new banking law (cf. former communal savings banks)! Investment firms <ul style="list-style-type: none"> • compulsory for stockbroking firms Financial cooperatives <ul style="list-style-type: none"> • voluntary Insurance undertakings (branch 21) <ul style="list-style-type: none"> • compulsory 	Credit institutions <ul style="list-style-type: none"> • Compulsory • No exemptions possible !!! • Branches (Recital 7 and Article 12): <i>DGS shall cover the depositors at branches set up by credit institutions in other Member States</i> <i>Every depositor must have a claim!</i>
(Article 3)	(Banking Law & RD 14 November 2008)	(Article 3)

II.2 Coverage – Scope

Scope of protection (beneficiaries)		
Directive 94/19/EC	Special Protection Fund (BE)	Proposal ≈ Political agreement
<p>“savers”</p> <ul style="list-style-type: none"> No specific scope ‘<i>ratione personae</i>’ <u>Possible</u> to exclude certain depositors / deposits by, e.g.: <ul style="list-style-type: none"> ✓ Fin institutions; ✓ Government; ✓ CIUs; ✓ Certain funds; ✓ Credit institution’s own managers; ✓ Large companies; ✓ Etc. <p>(Recitals 1, 16, and 21 + Annex I)</p>	<p>“clients of”</p> <ul style="list-style-type: none"> No specific scope ‘<i>ratione personae</i>’ Exclusion of deposits by: <ul style="list-style-type: none"> ✓ Credit institutions (+ their directors); ✓ Certain other fin institutions; ✓ Large companies; ✓ Government authorities; ✓ Etc. <p>→ Mostly “small savers”</p> <p>(Art. 5 & 10 RD 16 March 2009)</p>	<p>“consumers and non-financial businesses”</p> <ul style="list-style-type: none"> No specific scope ‘<i>ratione personae</i>’ <u>Mandatory</u> exclusion of deposits (+ earmarking obligation): <ul style="list-style-type: none"> ✓ Credit institutions; ✓ Certain other fin institutions; ✓ Deposits arising out of money laundering transactions; ✓ Public authorities; ✓ Etc. Derogations <u>possible</u> for certain deposits (pol agreement) <p>(Recitals 6,9,13, 18, and article 4 Political Agreement)</p>

II.2 Coverage – Scope

Covered assets: “deposits”

Directive 94/19/EC	Special Protection Fund (BE)	Proposal	Political agreement
Broad definition <ul style="list-style-type: none"> • Credit balance • Debt evidenced by a certificate <p>(Article 1)</p> <p><i>Min harmonisation</i></p>	Broad definition <ul style="list-style-type: none"> • Credit balance: <ul style="list-style-type: none"> ✓ EEA currency • Catch-all ? : ‘other debt instruments’: <ul style="list-style-type: none"> ➤ denominated in EEA currency; ➤ Issued by defaulting institution; ➤ registered, dematerialised, or under management account; • Shares in certain fin co-operatives? <p>(Art. 6 RD 16 March 2009)</p> <p>→ ... ? ... ←</p>	Narrow definition <ul style="list-style-type: none"> • Credit balance <ul style="list-style-type: none"> ➤ Regardless of currency ➤ Only if fully repayable • Exclusion of debt evidenced by a certificate <p>(Article 2)</p> <p><i>Max harmonisation?</i></p>	Narrow definition <ul style="list-style-type: none"> • Credit balance <ul style="list-style-type: none"> ➤ Regardless of currency ➤ Only if fully repayable • Exclusion of debt evidenced by a ‘fin instrument’, <u>unless</u> it is a savings product evidenced by a certificate made out to a named person <p>(Article 2)</p> <p><i>Max harmonisation?</i></p>

II.2 Coverage

ARCO



- Background

- Law of 15 October 2008 (implemented in art. 36/24 NBB Law)
 - Delegation of powers to the government to take specific measures
 - In case of “*sudden crisis*” or “*serious threat of a crisis*” on financial markets
- Use of these “special powers”:
 - RD 14 November 2008: creation Special Protection Fund
 - RD 10 October 2011: (optional) enlargement scope of application of Belgian DGS to cover cooperative shares
 - In ‘recognised’ (financial) cooperative companies;
 - Held by “non-institutional” shareholders (< 10% of total share capital)

II.2 Coverage

ARCO



- Timeline
 - RD 10 October 2011: enlargement scope of application DGS
 - 13 October 2011: application by Arcofin, Arcopar, and Arcoplus
 - RD 7 November 2011: membership to DGS accepted
 - 8 December 2011: dissolution of ARCO companies
- ARCO cooperants/shareholders protected by Special Protection Fund...?

II.2 Coverage

ARCO



- Action for annulment before Council of State
 - Against RD 10 October 2011
 - Grievances:
 - no “sudden” crisis on financial markets
 - RD issued by a government ‘in current business’ (“*lopende zaken*”)
 - Judgment (25 March 2013):
 - Confirmation government was allowed to conclude there was a risk of a “sudden” crisis because of the advice of the NBB that “*a state guarantee for shareholders in financial cooperatives can limit the effects of the crisis*”
 - Confirmation government was allowed to act using the “special powers” because “*enlarging scope of DGS to include shares in financial cooperatives is important to restore trust in financial system*”
 - **But:** discrimination between different categories of investors?
- Question referred to Constitutional Court for a preliminary ruling

II.2 Coverage

ARCO



- Constitutional Court
 - Discrimination?
 - Are individual shareholders in financial cooperatives different to 'other' shareholders (e.g.: Dexia shareholders) ?
 - Are “financial cooperatives” institutions of systemic importance?
 - Impact of EU law?
 - Maximum harmonisation of DGS (cf. definition of 'deposit')?
 - State aid?
- Judgment of April 24, 2014... to be continued...

II.3 Funding

II.3 Funding – EU

- Directive 94/14/EC - No harmonisation, only guidelines
 - costs of financing are borne, in principle, by credit institutions themselves;
 - the financing capacity of the scheme is in proportion to credit institutions' liabilities;
 - the stability of the banking system of the Member State concerned is not jeopardised.

Recital 23: *Whereas it is not indispensable, in this Directive, to harmonize the methods of financing schemes guaranteeing deposits or credit institutions themselves, given, on the one hand, that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities; whereas this must not, however, jeopardize the stability of the banking system of the Member State concerned;*

II.3 Funding – EU

- MS are free to define method(s) for financing
 - On what basis (eligible vs covered deposits)
 - When (ex ante / ex post / combined)
 - How much (flat-rate or risk-weighted contributions)
 - (Proposal: borrowing facilities)

II.3 Funding – Belgium

- Contributions
 - Special Protection Fund
 - Investment firms and branch offices
 - One-off access charge
 - Flat rate annual contribution
 - Credit institutions
 - Increase as of January 1, 2011:
 - One-off access charge
 - Flat rate annual contribution (0,15 % of eligible deposits)
 - Action for annulment before Constitutional Court by Argenta Spaarbank NV

II.3 Funding – Belgium



- Constitutional Court
 - Presumed discriminatory method of calculation of the contribution
 - Savings banks:
 - Financing: deposit-taking activities
 - Reinvestment: granting credits to consumers
 - their financial soundness does not directly affect the entire economy
 - Other credit institutions
 - Financing: capital markets
 - Reinvestment: sale of funds, securities, financial transactions

II.3 Funding – Belgium



- Constitutional Court

- Judgment no. 115/2011 of 23 June 2011

- Twofold reasoning:

- Annual contribution rate of 0,15 % of eligible deposits is not without reasonable justification compared to the service offered by the State
(cf. Art. 9 (4) Proposal: the cumulated amount may not exceed 1% of eligible deposits per calendar year)
 - However, not only the amount of a potential intervention, but also the risk that the government might have to intervene have to be taken into account.

- Risk indicator?

- The amount of a potential intervention; and
 - The risk of default of an institution (management)

- Conclusion:

- All credit institutions are treated in same manner, regardless of their risk profile
 - Annulment of calculation method

II.3 Funding – Belgium

- Contributions – Situation as of January 1, 2014
 - One-off access charge
 - Risk-based calculation for credit institutions (simplified):
 - $C_i = TC * RS_i$
 - Accounting-based indicators
 - Adequacy of own funds
 - Asset quality
 - Liquidity
- Creation of a resolution fund
 - Law of 28 December 2011
 - Task: “ensure financing of arrangements that diminish the impact of a defaulting credit institution on the financial system” (art. 2)

II.3 Funding – Towards harmonisation?

Financing		
Special Protection Fund (BE)	Proposal	Political agreement
No target level Ex ante contribution <ul style="list-style-type: none"> • One-off access charge • Risk based contributions <ul style="list-style-type: none"> ➢ $C_i = TC * RS_i$ • Risk indicators <ul style="list-style-type: none"> ➢ Adequacy of own funds ➢ Asset quality ➢ Liquidity <p>(Article 8 of the RD 14 November 2008)</p>	Target level (art. 9) <ul style="list-style-type: none"> • 1,5 % of <u>eligible</u> deposits • 10-year-target Ex ante contribution (art. 11) <ul style="list-style-type: none"> • Based on the degree of risk incurred by a specific member (one-off access charge not allowed) • Guidelines (Annex I & II) + delegation of powers to EU Commission to draft regulatory standards Extraordinary ex post contribution (art. 9) <ul style="list-style-type: none"> • 0,5 % of <u>eligible</u> deposits 	Target level (art. 9) <ul style="list-style-type: none"> • 0,8 % of <u>covered</u> deposits • 10 to 14 year target Ex ante contribution (art. 11) <ul style="list-style-type: none"> • Based on (i) the amount of covered deposits and (ii) the degree of risk incurred by the respective member • Guidelines to be issued by EBA within 1 year after entering into force Extraordinary ex post contribution (art. 9) <ul style="list-style-type: none"> • 0,5 % of <u>covered</u> deposits + possibility to ask higher contributions in exceptional circumstances

II.3 Funding – Towards harmonisation?

Borrowing-facilities

Proposal (Article 10)

What?

- DGS has a right to borrow from all other DGS within the Union

When?

- DGS cannot fulfil its obligations due to a lack of means available;
- DGS made recourse to extraordinary contributions;
- DGS is not currently subject to a repayment obligation to another DGS;
- Total amount lent < 0,5 % of eligible deposits of borrowing scheme;
- Etc.

Conditions:

- Repayment within max 5 years
- Interest rate = marginal lending facility rate ECB

Political agreement (Article 10)

What?

- MS may allow DGS to lend to other schemes within the Union on a voluntary basis

When?

- DGS cannot fulfil its obligations due to a lack of means available;
- DGS made recourse to extraordinary contributions;
- DGS is not currently subject to a repayment obligation to another DGS;
- Total amount lent < 0,5 % of covered deposits of borrowing scheme;
- Etc.

Conditions:

- Repayment within max 5 years
- Interest rate \geq marginal lending facility rate ECB

III. Conclusion – Questions?

- Pan-EU DGS → complicated!
- First steps?
- Questions?